Petition

81-544

Office - Supreme Court, U.S.
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ALEXANDER L. STEVAS,

NO._____

SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1981

RONALD R. SILVERTON, AND B. SILVERTON,
PETITONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Whether the costs advanced by a lawyer on behalf of a client, where the right to reimbursement is contingent on winning or settling the case, are ordinary and necessary business expenses of a lawyer under § 162 (a) of the United States Internal Revenue Code of 1954 (26 U.S.C.), or whether such advanced costs constitute loans and as such are not deductible except when those costs remain unrecovered when a case is lost or otherwise closed.

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SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1981

RONALD R. SILVERTON, AND B. SILVERTON,
PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Petitioners, Ronald R. Silverton and B. Silverton,[1/] pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 26, 1981.

1/ At all times herein the reference to "taxpayer" shall refer to Petitioner Ronald R. Silverton, since the issue presented pertains to his activities, and involves B. Silverton only because she filed a joint return with her husband, Ronald R. Silverton, for those years in issue after 1969.

OPINION BELOW

The opinion of the Court of Appeals, not yet reported, appears in the appendix hereto as exhibit "A". The order of the Court of Appeals denying a Petition for Rehearing and the Suggestion for Rehearing En Banc appears in the appendix hereto as exhibit "B".

The opinion of the United States Tax Court is reported at U.S. T.C.-memo 1977-1981, and appears in the appendix hereto as exhibit "C", in abbreviated form.[2/]

2/ The decision of the tax court comprises 64 pages, and covers 9 issues. Only one issue (issue number "1") set forth in its opinion is relevant to the instant proceeding. Therefore attached hereto as exhibit "C", are only those pages of the tax court decision that touch the issue here under consideration, or are helpful in linking the content of those pages-pp: 1-11, 29-35. In addition to the tax court decision here referred to there was a second tax court decision in this same controversy, United States Tax Court Memo 1978-433, filed on Oct. 31, 1978 that did not pertain in any particular to the issues with which this Petition is concerned.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on March 26, 1981. A timely Petition for Rehearing En Banc was denied on June 17, 1981, and this Petition for Certiorari was filed within 90 days of that date as required by 28 U.S.C. 2101(c). This court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTION PRESENTED

Whether the costs advanced by a lawyer on behalf of a client, where the right to reimbursement is contingent on winning or settling the case, are ordinary and necessary business expenses of a lawyer under § 162 (a) of the United States Internal Revenue Code of 1954 (26 U.S.C.), or whether such advanced costs constitute loans and as such are not deductible except when those costs remain unrecovered when a case is lost or otherwise closed.

STATUTORY PROVISION INVOLVED

26 U.S.C.S. §162(a)

§162. Trade or business expenses.
(a) In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business including— . . .[3]

This Petition only concerns the first phrase of §162 (a): "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ."

STATEMENT OF THE CASE

The facts pertaining to this issue are not in dispute. Those relevant are verbatim taken from the fact summary of the opinion on this issue, written by the United States Tax Court.[4/]. "During the years in issue and prior to August 1972, taxpayer, a lawyer, owned and operated the law firm of Silverton &

3/ The entire statute, 26 U.S.C. §162(a) is set forth in the appendix as exhibit "D".

4/ Pages 7-11 of said opinion. The only change is a substitution in this rendition of the designation "Taxpayer" instead of "Petitioner"; and the elimination of the footnotes.

Silverton. The firm employed a staff of approximately 70 person, of whom 14 were lawyers. The firm's principal office was located in Los Angeles, California. During the years in question, taxpayers' law firm also had offices in Santa Ana, San Diego, Wilmington, and San Francisco, California.

Taxpayer entered the practice of law in 1958 and, as of the time period pertinent herein, had gradually developed an extensive practice comprised primarily of group legal services for existing organizations such as church groups and labor unions. In exchange for a nominal monthly retainer, taxpayers' firm provided members of the particular church or union group with legal advice.

On Schedule C of his income tax return, taxpayer reported gross receipts, less returns and allowances, and net profit for his law firm for the following years in the following amounts:

	1968	1969	1970	1971	1972
Rcpts.	$968,522	$1,145,614	$1,300,536	$1,621,727	$437,905
Net Profit	53,474	80,500	171,343	14,391	(77,445)

Most of the firm's income was derived from personal injury and/or Worker's Compensation claims prosecuted on behalf of participants in the group programs. For cases involving either type of claim, the firm operated under a contingent fee ar-

rangement. Once it was determined after initial consultation that the claim had sufficient merit so as to warrant prosecution, the client executed a retainer which provided that case preparation and litigation costs (investigation expenses, filing fees, witness fees, etc.) would be paid by the firm and that only upon the successful prosecution and settlement of the claim would the firm be entitled to recover those costs. Upon a recovery, either by settlement or after trial, the case preparation and litigation costs, which had been recorded on the client's ledger were repaid to the firm from the amount recovered. The firm's fee, 33⅓ percent of the settlement payment and 40 percent of a judgment award, was then computed on the basis of the net proceeds. If the case were lost, the costs were borne by the firm and the client owed nothing. Nor was the client obligated to pay the unrecovered costs in the event the settlement or judgment received was less than the case preparation and/or litigation expenses incurred by the firm.

Taxpayer characterized the clientele as predominantly "working class" and estimated that 75 to 85 percent of the firm's clients were members of an ethnic minority. Taxpayer believed that by virtue of the group programs and the contingent fee policy, the firm was able to provide legal services to clients who might not otherwise have been able to afford

them. Where a client to whom legal services had been rendered on the fixed fee basis was unable to pay, collection of the account receivable established therefor was not enforced; taxpayer never sued an individual client for fees owed to the firm.

For each client represented on the contingent fee arrangement, the firm maintained a ledger card upon which was recorded the case preparation and /or litigation costs paid by the firm in connection with the client's case. Prior to and including the years in issue, all such costs paid during the taxable year were treated as current business expenses and deducted by taxpayer on Schedule C (Profit or Loss from Business or Profession) of his income tax return for that year, even though at the year's end, a number of the cases on which he deducted related expenditures remained outstanding and were not closed until a subsequent taxable year. When a case was closed after settlement or trial, both the case preparation and/or litigation costs recovered and the firm's contingent fees were included in the income in the year of receipt. Where, on the basis of periodic reports submitted by the firm's department heads, cases were designated as "dead" (i.e., inactive or lost), the costs reported on the corresponding client ledger cards were added up at the end of the year and entered on the firm's books as a bad debt. This total was a balancing entry only;

that is, the bad debt entry for the particular year was not used in taxpayer's computation of taxable income for that year, since it reflected amounts which should have already been claimed as deductions.

Specifically, on Schedule C of his income tax return for each of the years 1968, 1969, 1970, taxpayer deducted the firm's current case preparation and litigation expenses. Of these deductions claimed, the Commissioner disallowed amounts which represented the excess of the current case preparation and litigation expenses deducted by petitioner over the sum above (1) the costs recovered and included in income for the year and (2) the expenses attributable to cases lost or otherwise closed during the year.

After the rendition of the aforestated facts in its opinion the United States Tax Court on page 30 of its opinion, in footnote 17, concurred in the Respondent Commissioner's characterization of the costs expended as non-deductible loans as follows:

> "[17]Were this a matter of first impression the writer would be more dubious about whether these advances should be characterized as loans because the writer fails to find any obligation on the part of the client to repay. The attorney looks only to the amounts recovered for repayment. Also in an operation as extensive as petitioner's in this case,

where literally thousands of clients' ledger cards are involved each year, it would be very difficult to determine accurately which cases were lost or abandoned as of the end of a particular year, and petitioner's method of accounting for the advances would probably more clearly and accurately reflect the income of the law firm. Over a period of years, if there is no change in ownership, the overall result should be the same under both methods, but such was not the case here, and it would have been an almost impossible task for the revenue agent to analyze all the client ledger cards as of the end of each year here involved. Nevertheless, we feel bound to follow the prior opinions of this Court under almost identical circumstances and the decisions of the Ninth Circuit, to which an appeal in this case would lie. See **Glosen v. Commissioner,** 65 T.C. 742 (1970), aff'd. 445 F. 2d 985 (10th Cir. 1970), cert. den., 404 U.S. 940 (1971)."

The Ninth Circuit Court of Appeals concurred with the Tax Court's above set forth expression of doubt concerning the Commissioner's interpretation of 26 U.S.C. §162(a). The judges of the Court of Appeals

expressed this concurrence in footnote 2 on page two of their opinion as follows (the complete opinion is in the appendix as exhibit "A" to this Petition):

> "[2]We note that the Tax Court expressed doubt whether such expenses should be classified as loans, see Tax Court Opinion at 30 n. 17, but felt bound by **Canelo.** We agree both with the expression of doubt and the conclusion regarding the applicability of **Canelo.**"[5]

REASONS FOR GRANTING THE WRIT

The decision below reluctantly let stand the construction of an important federal tax statute that unfairly affects a large segment of our country's population. This construction has never been considered by this court.

The commissioner of Internal Revenue (Respondent herein) has construed 26 U.S.C. 162(a) to preclude lawyers from deducting on their tax return in the year expended costs paid by them in preparing for settlement and/or trial of a case in which these costs may be reimbursed to the lawyers in a

5/"Canelo" refers to **Canelo v. Commissioner** 53 T.C. 217 (1969), affirmed 447 F.2d 484 (Ninth Cir. 1971); which is discussed infra.

future year from the res created by the winning or settlement of the case. This despite the fact that the lawyer shows cost recovery as income on the tax return in the year of the reimbursement.

Rule 5-104 of the California State Bar Rules of Professional Conduct expressly states that a member of the state bar is not prohibited:

> "... (3) from advancing the costs of prosecuting or defending a claim or action ..."[6/]

American Bar Association Ethical Consideration 2-23 suggests that clients should not be sued except to prevent gross imposition. The Committee on Professional Ethics of the California State Bar in Formal Opinion No. 1976-38 opines that a lawyer may ethically take a case and agree to advance costs knowing there is no possibility that the client will be able to repay them if there is no recovery.

The same justification for contingent fees provides the justification for the costs to be advanced by the lawyer subject to reimbursement out of the

6/ Rule 5-104 of the Rules of Professional Conduct of the California State Bar is set forth in total in the appendix as exhibit "E".

res produced by the successful prosecution of the claim . . .[7/]

Internal Revenue Code Section 162 (a) provides that there shall be allowed as a deduction all of the ordinary and necessary expenses, paid or incurred, during the taxable year in carrying on a trade or business. It would seem reasonable to assume that a personal injury attorney advancing the costs of litigation from which he hopes to obtain his contingent fee, is advancing expenses of carrying on his profession. Is not the lawyer's profession, his trade or business?

Taxpayers, in the instant case, are analogous to a merchant incurring costs to prepare his merchandise for sale. The attorneys at taxpayer's firm expended costs to prepare a case for trial with no enforceable obligation arising from the client to repay the costs expended.

7/ Ethical Consideration 2-20 of the American Bar Association Model Code of Professional Responsibility, as amended 2/80, reads in pertinent part: "EC 2-20 Contingent fee arrangements in civil cases have long been commonly accepted in the United States in proceedings to enforce claims. The historical basis of their acceptance are that (1) they often, and in a variety of circumstances, provide the only practical means by which one having a claim against another can economically afford, finance, and obtain the services of a competent lawyer to prosecute his claim, and (2) a successful prosecution of the claim produces a res out of which the fee can be paid . . . " (footnotes omitted).

This Court should take notice that it is many years before a substantial portion of the cases that go to trial are concluded and that some portion of these cases never actually conclude, but "fade away." The lawyer must deduct these costs sometime in the future when either the case does not result in any income to him or as a deduction from that income. To that extent, he has lost the interest value of the amount of the deduction for the many years that it takes for the case to come to fruition.

Another compelling reason for the Court permitting law firms to deduct costs and expenses as incurred and to show them as income when received back is the elimination of unnecessary recordkeeping and analysis that a contrary rule requires of lawyers years after the expenditures of the costs. The current law imposes on lawyers, most of whom are small businnessmen, individual practitioners that employ only a secretary, the burden of storing and carrying otherwise unnecessary documents that verify payment of costs from year to year to make sure that they are deducted when the case finally comes to fruition or is lost or for some other reason is terminated.

It is a paradox that the current law seems to require a lawyer on the cash basis, whose stock and

trade is his time, to squander it by keeping track of costs expended years before, whereas other cash basis businessmen may deduct costs attaching to their product when these costs are expended.

You may respond that one of the detriments to being in the law profession is that you have a cash flow problem that many other businesses don't have.[8] However, this cash flow problem transmits itself to society as a whole, since an attorney, not being able to deduct the costs associated with preparing his product for market as do other businesses, passes this higher cost of doing business on to the general public. Instead of his contigent fee going down, it stays high. This cash flow problem of the lawyer is a problem of higher legal fees to society.

The Court of Appeals to whose review the decision of the Tax Court was directed stated in their Opinion:

> "**Canelo** is binding upon us and is controlling here." (page 2, lines 13-14 of said Opinion which is in the appendix as exhibit "A" to this Petition).

8/ Lawyers constitute a large and increasing amount of the population of the United States. This country now has more than 535,000 lawyers, an increase of about 50% over the number 10 years ago, according to findings reported in New Orleans La on August 8, 1981 at the annual convention of the American Bar Association by the American Bar Foundation, a private non-profit research institute that gathered information reported to legal directories in the spring of 1980.

Of all the cases cited by the Commissioner in its brief to the Ninth Circuit Court of Appeals two are squarely in point: **Canelo v. Commissioner,** 53 T.C. 217 (1969), affid'd. 447 F.2d 484 (Cal. 4/9/71); and **Herrick v. Commissioner,** 63 T.C. 556 (1975). Both of these cases are identical to the instant case in three critical respects:

(1) The taxpayers are lawyers; and the business involved is a law firm.

(2) The costs deducted were costs for preparing the legal case which may produce income in a subsequent tax year for the taxpayer (if income was produced from the case in the year in question, the case preparation costs were permitted to be deducted).

(3) The costs expended would only be recouped by the taxpayer to the extent he was successful in the case.

In reliance on those two cases, **Canelo, supra,** and **Herrick, supra,** the Commissioner, argues that the critical difference between a businessman expending funds on his product and a lawyer expending costs to prepare a contingency case for presentation (to a fact-finding tribunal or claims adjuster) has already been decided by the Courts in those cases. This difference, as set forth in those cases and quoted by the Commissioner in its brief, is that case preparation costs are:

> " . . . made on behalf of a particular client, under a reimbursement agreement signed by the client, to pursue a claim held by the client. The claim is of no use to any person other than the client."9/

The above reasoning caused the Court in **Canelo** to uphold the Commissioner's disbursement of attorney Canelo's case preparation costs advanced by his law firm in 1960, 1961, and 1962. This distinction is also the basis of the decision by the Tax Court in **Herrick v. Commissioner, supra,.** The **Herrick** case is the latest in a number of assaults by attorneys on the Commissioner's failure to permit lawyers a deduction in the year expended for preparation costs on cases until the case is resolved.

The Court, in **Herrick,** explained that the facts of that case are not distinguishable from the **Canelo** case, on its facts, and that **Canelo** properly interpreted the holding in **Burnett v. Commissioner,** 365 F.2d 755 (1966). The Court in **Herrick** then adopted the decision in **Canelo** as it understood it to be based on the holding in **Burnett v. Commissioner, supra,.** The Court, in **Herrick,** explained that decision in **Burnett** (568 U.S.T.C. at 562) by setting forth two critical differences between a deductible business expense and an advance payment by an attorney for case preparation. Those two critical differences as set forth, were:

9/ Page 15 of the brief of the Commissioner/Appellee to U.S. Court of Appeals for the Ninth Circuit.

(1) Expectation of substantial repayment by the attorney of his advance.

(2) A high rate of recovery by the attorney of the advances.

It is obvious that the two given reasons would also apply virtually to every situation in which a successful businessman expends funds in preparing his product for the marketplace. Taxpayer submits that the real, but unexpressed reasons for the Court's distinguishing case preparation expense by lawyers from product preparation costs by others, is the anachronistic view that lawyers are not in business and that their contingent fee cases are not products. This view of lawyer's cases and fees has been disparaged by the United States Supreme Court in the following three cases decided after the **Canelo** decision:

(1) **United States Transportation Union v. State Bar of Michigan,** 401 U.S. 576, 28 L.Ed. 2d 339, 91 S.Ct. 1076 (1971).

In that case, the Court reversed the lower court and held that a union could control the legal fees offered its members and could advertise that its attorneys would defray all litigation costs if they were used by the members.

(2) **Goldfarb v. Virginia State Bar,** 421 U.S. 773, 44 L.Ed. 2d 572, 95 S.Ct. 2004 (1975).

In that case, the high court prohibited the State

Bar Association from interferring with an attorney's right to work out his own arrangement for receiving compensation payment for services.

(3) **Bates and Van O'Steen v. State Bar of Arizona,** 433 U.S. 350, 53 L.Ed. 2d 800, 97 S.Ct. 2691 (1977).

In that case, the high court permitted lawyers to advertise their products and costs.

Taxpayer believes that the time is now for this Honorable Court to lay aside the view that case preparation costs by a lawyer are different from manufacturing costs by a manufacturer and permit lawyers to deduct costs expended rather than treating the expenditures as "non-loan" advances. A non-loan advance is one that cannot be expensed under **Internal Revenue Code** Section 162(a) nor treated as a loan under **Internal Revenue Code** Section 165 (**See Herrick v. Commissioner, supra.**).

The fair administration of this tax statute is important for the reasons above set forth. As this court recently stated:

> "We cannot ignore the reality that the **tax laws** affect the shape of nearly every business transaction." — Justice Harry Blackman, writing for the majority in **Frank Lyon Co. v. U.S.**, 435 US 561, 55 L.Ed. 2d 550, 98 S.Ct. 1291 (1978).

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit Court of Appeals.

Respectfully submitted,
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APPENDICES

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APPENDIX "A"

FILED
MAR 26 1981
RICHARD H. DEANE
CLERK, U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RONALD R. SILVERTON AND B. SILVERTON,
APPELLANTS,

vs.

COMMISSIONER OF INTERNAL REVENUE,
APPELLEE.

NO. 79-7269

T.C. NO. 8905-72
8906-72
8907-72
7799-75

MEMORANDUM

Appeal from the United States Tax Court
Argued and Submitted — March 4, 1981
Decided —

Before: HUG, FERGUSON, and REINHARDT,
Circuit Judges

This is an appeal from a decision of the Tax Court assessing deficiencies in taxpayer's[1/] federal income taxes for the years 1968, 1969, 1970, and 1972. We affirm that decision.

The Commissioner of Internal Revenue (hereinafter the Commissioner) determined deficiencies in taxpayer's federal income tax returns for the years in question. Taxpayer contested these deficiencies determined by the Commissioner. A hearing was then held pursuant to Rule 155 of the Tax Court Rules of Practice and Procedure to determine the extent of those deficiencies. At this hearing, the Tax Court refused to consider whether income in 1969 should be allocated between taxpayer and his former wife. On appeal, taxpayer

1/ B. Silverton is a party to this proceeding. She filed a joint return with Ronald Silverton for the years 1970 through 1973. The issues before us relate principally to Ronald Silverton and he will be referred to as taxpayer.

challenges three of the eight findings of deficiency by the Tax Court and the refusal by the Tax Court to consider the question of allocation at the Rule 155 hearing.

First, taxpayer, a lawyer, contends that case preparation and litigation costs in cases handled on a contingent fee and reimbursement basis should be deductible as business expenses in the year incurred. In **Canelo v. Commissioner,** 53 T.C. 217, 223-227 (1969), **aff'd per curiam** 447 F.2d 484 (9th Cir. 1971) this Court held that litigation expenditures made by a lawyer under a contingent fee and reimbursement contract are loans and therefore are not deductible as business expenses. **Canelo** is binding upon us and is controlling here.[2]

Second, taxpayer argues that amounts paid by him to a creditor during 1969 should be deductible as interest payments solely because he and the creditor agreed to call the year's payments "prepaid interest" for tax purposes. In fact, the payments served to reduce the principal amount owed. Taxpayer's argument is without merit.

2/ We note that the Tax Court expressed doubt whether such expenses should be classified as loans, **see** Tax Court opinion at 30 n. 17, but felt bound by **Canelo.** We agree both with the expression of doubt and the conclusion regarding the applicability of **Canelo.**

Third, taxpayer asserts that there was not a completed sale of his property at 3630 Wilshire Boulevard in 1972 and that the proceeds from the sale are not properly includible in gross income for that year. The Tax Court's conclusion that there was a completed sale in 1972 is not "clearly erroneous."

Finally, taxpayer contends that the Tax Court should have considered the question of allocation at the Rule 155 hearing. At no time prior to the Rule 155 hearing was the question of allocation raised. Rule 155(c)[3/] expressly precludes raising new issues at Rule 155 hearings, and the Tax Court properly denied taxpayer's request that the question of allocation be considered.

The decision of the Tax Court is therefore **affirmed.**

3/ Rule 155 (c) provides:

> Any argument under this Rule will be confined strictly to consideration of the correct computation of the deficiency, liability, or overpayment resulting from the findings and conclusions made by the Court, and no argument will be heard upon or consideration given to the issues or matters disposed by the Court's findings and conclusions or to any new issues. This Rule is not to be regarded as affording an opportunity for retrial or reconsideration.

APPENDIX "B"

FILED
JUN 17 1981
RICHARD H. DEANE
CLERK, U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RONALD B. SILVERTON AND B. SILVERTON,
APPELLANTS,

vs.

COMMISSIONER OF INTERNAL REVENUE,
APPELLEE.

NO. 79-7269

T.C. NO. 8905-72
8906-72
8907-72
7799-75

ORDER

Before HUG, FERGUSON, and REINHARDT, Circuit Judges

The panel has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge of this court has requested a vote on the suggestion for rehearing en banc.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

APPENDIX "C"

T.C. Memo. 1977-198

UNITED STATES TAX COURT

RONALD R. SILVERTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT,

RONALD R. SILVERTON AND B. SILVERTON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

DOCKET NOS. 8905-72, 8906-72 8907-72 7799-75
Filed June 28, 1977.

Petitioner was the owner of a law firm that provided legal services to union groups and their members, church groups and their members, and ethnic groups, mostly on a contingent-fee basis. Petitioner was incarcerated in 1972 and sold the business.

Held:

1. Case-preparation and litigation costs advanced by petitioner and recoverable only from the proceeds of suit or settlement were not deductible by petitioner in the year advanced unless the case was closed out in that year. **Canelo v. Commis-**

sioner, 53 T.C. 217 (1969), and **Herrick v. Commissioner,** 63 T.C. 562 (1975), followed.

2. Amounts of deductible "employee extraordinary expenses" consisting of meeting with and entertaining leaders and members of the groups determined.

3. Petitioner failed to satisfy the substantiation requirements of section 274 with respect to travel and entertainment expenses.

4. Petitioner may not deduct in 1969 an amount designated as prepaid interest.

5. The cost of a trailer used by petitioner as an office was a capital expenditure rather than a business expense.

6. Petitioner realized ordinary gain on the sale of his law business in 1972; amount of gain determined.

7. Petitioner sold his office building and furniture and fixtures in 1972; amount of gain determined.

8. Petitioner is not liable for the addition to tax under sec. 6653(a), I.R.C. 1954, for the years 1968, 1969, and 1970.

9. Petitioner is liable for the addition to tax under sec. 6651(a), I.R.C. 1954, for the year 1972.

Ronald R. Silverton, pro se.

John O. Kent for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, **Judge:** Respondent detemined deficiencies and additions to tax in respect of petitioners' Federal income tax liability as follows:

Docket No.	Petitioner(s)	Year
8905-72	Ronald R. Silverton	1968
8906-72	Ronald R. Silverton	1969
8907-72	Ronald R. Silverton and B. Silverton	1970
7799-75	Ronald R. Silverton and B. Silverton	1972

Deficiency	Addition to tax under sec. 6651(a)	sec. 6653(a)[1]
$78,557.30	—	$3,927.86
201,233.00	—	10,061.65
168,003.44	—	8,400.17
6,874.84	$1,718.71	—

Certain concessions have been made by the parties so that the following principal issues remain for decision:

(1) Whether petitioners are entitled to deduct as ordinary and necessary business expenses under section 162 the amounts expended in each of the years 1968 through 1972, inclusive, as case-preparation and litigation costs for petitioner's clients, where recovery of such costs is contingent upon the successful settlement or prosecution of the clients' claims;[2]

1 All statutory references are to the Internal Revenue Code of 1954, as amended and in effect in the years at issue.

2 Resolution of issues (1) and (2) will in turn determine whether petitioners incurred a net operating loss in 1971 in excess of $66,943 which amount respondent concedes is available to petitioners as a carryback to the years 1968, 1969, and 1970.

(2) Whether the "employee extraordinary expenses" deducted by petitioner(s) in each of the years 1968 through 1971, inclusive, constitute entertainment expenses to which section 274 applies, and if so, whether such expenses have been substantiated as requireed by section 274;[3]

(3) Whether petitioners have satisfied the substantiation requirements of section 274 so as to entitle them to the various business deductions claimed in 1968, 1969, and 1970 for travel and entertainment expenses;

(4) Whether petitoner Ronald R. Silverton may deduct in 1969 a prepaid interest expense payment in the amount of $21,482.55;

(5) Whether the cost of a trailer acquired in 1969 for use as an office constitutes a deductible business expense or a capital expenditure;

(6) Whether petitioner Ronald R. Silverton realized gain upon the sale of his law practice in 1972 and if so, the character of that gain;

(7) Whether certain property (an office building, furniture and fixtures) used by petitoner Ronald R.

3 See fn. 2, **supra.**

Silverton in his law practice was sold by petitioner in 1972[4] and if so, the amount of gain realized therefrom;

(8) Whether in each of the years 1968, 1969 and 1970 petitioners are liable for the addition to tax asserted by respondent pursuant to section 6653(a) for negligence or intentional disregard of rules and regulations; and

(9) Whether petitioners are liable for the additin to tax asserted by respondent pursuant to section 6651 (a) for petitioners' failure to file timely their 1972 income tax return.[5]

4 Dependent on whether a sale of the above-specified property occurred in 1972 are two derivative issues: Whether petitioners are entitled to an entire year's depreciation for 1972 on that property and whether petitioners sustained a loss on that property in 1973, which loss would result in a net operating loss for 1973 in excess of the $6,709 that respondent determined was available as a carry-back to 1970.

5 Petitioner offered no evidence with respect to, and did not mention on brief, certain issues raised in the pleadings and mentioned by respondent on brief; we assume petitioner has conceded those issues.

FINDINGS OF FACT

Some of the facts have been stipulated and are accordingly so found.

Petitioners Ronald R. Silverton and B. Silverton (also known as Hilda Silverton) were married in 1970, and at the time of the filing of the respective

petitions herein petitioners resided in Los Angeles, Calif.

Petitioner Ronald R. Silverton filed a joint return for 1968 with his then-wife Fawn Silverton. For 1969, Ronald R. Silverton filed an individual income tax return as to which the parties agree petitioner was entitled to head-of-household status. Petitioners Ronald R. and B. Silverton filed a joint income tax return for each of the years 1970 through 1973.[6] All of petitioners' income tax returns for the period 1968-1973 were timely filed except that for 1972 which was filed with the Fresno Service Center on February 5, 1974. Hereinafter we shall refer to Ronald R. Silverton as either petitioner or Silverton since the issues presented pertain to his

6. For each of the taxable years 1968 and 1969, B. Silverton timely filed an individual income tax return (in her maiden name Brunhilde Goerlich). These returns are relevant to the application of the net operating loss carry-backs from 1971 to which petitioners may be entitled and have accordingly been stipulated into evidence.

activities and involve B. Silverton only because she filed a joint return with her husband for those years in issue after 1969.

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During the years in issue, and prior to August 1972, petitioner, a lawyer, owned and operated the law firm of Silverton & Silverton.[7] The firm employed a staff of approximately 70 persons, of whom 14 where lawyers. The firm's principal office was located in Los Angeles, Calif. During the years in question. petitioner's law firm also had offices in Santa Ana, San Diego, Wilmington, and San Francisco Calif.

Petitioner entered the practice of law in 1958 and, as of the time period involved herein, had gradually developed an extensive practice comprised primarily of group legal services for existing organizations such as church groups and labor unions. In exchange for a nominal monthly retainer, petitioner's firm provided members of the particular church or union group with legal advice.

7. In certain instances, the firm is referred to as the Silverton Law Corp. Since each schedule C accompanying petitioner's income tax returns for the years in issue reports the firm's name as Silverton & Silverton and that it was owned by petitioner, we have therefore treated the law firm as a sole proprietorship and do not understand the parties contend otherwise.

On schedule C of his income tax returns petitioner reported gross receipts, less returns and allowances, and net profit for his law firm for the years and in the amounts following:

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	1968	1969	1970
Receipts	$968,522	$1,145,614	$1,300,536
Net Profit	53,474	80,500	171,343
	1971	**1972**	
Receipts	$1,621,727	$437,905	
Net Profit	14,391	(77,445)	

Most of the firm's income was derived from personal injury and/or workman's compensation claims prosecuted on behalf of participants in the group programs.[8] For cases involving either type of claim, the firm operated under a contingent-fee arrangement. Once it was determined after initial consultation that the claim had sufficient merit so as to warrant its prosecution, the client executed a retainer which provided that case-preparation and litigation costs (investigation expenses, filing fees,

8. The firm did some domestic relations, criminal defense, and probate work on a fixed-fee basis in accordance with the appropriate local bar association's minimum fee schedule. For participants in the group programs, these fees were approximately 20 percent less than those for clients who were not part of a group plan.

witness fees, etc.) would be paid by the firm and that only upon the successful prosecution or settlement of the claim would the firm be entitled to recover those costs. Upon a recovery, either by settlement or after trial, the case-preparation and litigation costs which had been recorded on the client's ledger were repaid to the firm from the amount recovered. The firm's fee, 33⅓ percent of a settlement payment and 40 percent of a judgment award, was then computed on the basis of the net proceeds. If the case were lost, the costs were

borne by the firm, and the client owed nothing. Nor was a client obligated to pay the unrecovered costs in the event the settlement or judgment received was less than the case preparation and/or litigation expenses incurred by the firm.

Petitioner characterized his clientele as predominantly "working class" and estimated that 75 to 85 percent of the firm's clients were members of an ethnic minority. Petitioner believed that by virtue of the group programs and the contingent-fee policy, he was able to provide legal services to clients who might not otherwise have been able to afford them. Where a client to whom legal services had been rendered on a fixed fee basis (see fn. 8, **supra,**) was

unable to pay, collection of the account receivable established therefor was not enforced; petitioner never sued an individual client for fees owed to the firm.

For each client represented under the contingent-fee arrangement, the firm maintained a ledger card on which were recorded the case-preparation and/or litigation costs paid by the firm in connection with the client's case. Prior to, and including the years in issue, all such costs paid during a taxable year were treated as current business expenses and deducted by petitioner on schedule C (Profit (or Loss) From Business or Profession) of his income tax return for

that year even though at year's end a number of the cases to which the deducted expenditures related remained outstanding and were not closed until a subsequent taxable year. When a case was closed after settlement or trial, both the case-preparation and/or litigation costs recovered and the firm's contingent fee were included in income in the year of receipt. Where, on the basis of periodic reports submitted by the firm's department heads, cases were designated as dead (i.e. inactive) or lost, the costs reported on the corresponding client ledger cards were added up at the end of the year and

entered on the firm's books as a bad debt. This total was a balancing entry only; that is, the bad debt entry for a particular year was not used in petitioner's computation of taxable income for that year since it reflected amounts which had already been claimed as deduction.[9]

Specifically, on schedule C of his income tax return for each of the years 1968, 1969, and 1970, petitioner deducted the firm's current case-preparation and litigation expenses. Of these deductions claimed, respondent disallowed the respective

9. Interestingly, neither party has mentioned the method of accounting used by petitioner in computing his business profit (or loss). We note, however, that the schedule C accompanying petitioner's return for 1968 designates the accrual method, those for 1969 and 1970, the cash basis method, and those for 1971 and 1972, the accrual method.

amounts of $35,179.20, $61,489.93, and $72,397.08,

which he instead determined to be deductible in 1971. For 1971 and 1972, respondent disallowed $77,843 and $21,019, respectively, of the current case-preparation and litigation expenses claimed by petitioner in those years; if the $77,843 disallowed for 1971, respondent determined $38,922 to

be allowable for 1972. The amount disallowed by respondent in each year represents the excess of current case-preparation and litigation expenses deducted by petitioner over the sum of (1) the costs recovered and included in income for the year and (2) the expenses attributable to cases lost or otherwise closed during the year.

For each general category of organizations participating in the group programs, i.e., the union groups and the church groups, petitioner employed a liaison person whose duties entailed meeting with a group's representatives to discuss problems and complaints pertaining to the firm's services to that group's members. The liaison person served to facilitate communication between the particular participating group and the firm; that individual was not a lawyer and rendered no legal advice.

Arthur L. Ball (hereinafter referred to as Ball) performed the liaison function for union groups. Ball began serving the firm in this capacity in 1966 when approximately 6,000 or 7,000 individual members (exclusive of their families) . . .

OPINION

In each of the years 1968 through 1972, inclusive, petitioner claimed a deduction for the amounts paid by his law firm in the respective years for case-preparation and/or litigation costs incident to the prosecution of personal injury or workmen's compensation cases where recovery of such costs was contingent upon the successful settlement or litigation of the case. The issue raised thereby which we must decide is whether the costs advanced on behalf of clients are, as petitioner maintains, ordinary and necessary business expenses deductible under section 162, or whether, as respondent determined, notwithstanding the contingent nature of the firm's right to reimbursement, such advanced costs constituted loans and as such, are not deductible except to the extent that costs remain unrecovered when a case is lost or otherwise closed.

We agree with respondent that our prior opinions in **Canelo v. Commissioner,** 53 T.C. 217 (1969), aff'd. per curiam 447 F. 2d 484 (9th Cir. 1971), and **Herrick v. Commissioner,** 63 T.C. 562 (1975), require characterization of the costs at issue as

loans.[17] **Canelo v. Commissioner, supra,** involved a law firm which engaged primarily in plaintiffs' personal injury litigation on a contingent-fee basis similar to the arrangement herein: Costs advanced by the firm were repaid only in the event of a settlement or judgment in favor of the client; and if there were no recovery, the client owed nothing. The law firm screened prospective clients and took only cases as to which it had "good hopes" of recovery. In holding that the advanced costs constituted loans, rather than business expenses deductible under section 162, the Court began its analysis by reference to the general proposition:

17 Were this a matter of first impression the writer would be more dubious about whether these advances should be characterized as loans because the writer fails to find any obligation on the part of the client to repay. The attorney looks only to the amounts recovered for repayment. Also in an operation as extensive as petitioner's in this case, where literally thousands of clients' ledger cards are involved each year, it would be very difficult to determine which cases were lost or abandoned as of the end of a particular year, and petitioner's method of accounting for the advances would probably more clearly and accurately reflect the income of the law firm. Over a period of years, if there is no change in ownership, the overall result should be the same under both methods, but such was not the case here, and it would have

been an almost impossible task for the revenue agent to analyze all the client ledger cards as of the end of each year here involved. Nevertheless, we feel bound to follow the prior opinions of this Court under almost identical circumstances and the decisions of the Ninth Circuit, to which an appeal in this case would lie. See **Golsen v. Commissioner,** 54 T.C. 742 (1970), affd. 445 F. 2d 985 (10th Cir. 1971), cert. denied 404 U.S. 940 (1971).

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> "It has been firmly established that where a taxpayer makes expenditures under an agreement that he will be reimbursed therefor, such expenditures are in the nature of loans or advancements and are not deductible as business expenses." **Josef C. Patchen,** 27 T.C. 592, 600 (1956). Accord, **Levy v. Commissioner,** 212 F. 2d 552 (C.A. 5, 1954), affirming a Memorandum Opinion of this Court; **Glendinning McLeish & Co.,** 24 B.T.A. 518 (1931), affd. 61 F. 2d 950 (C.A. 2, 1932); **Henry F. Cochrane,** 23 B.T.A. 202 (1931). * * * [53 T.C. at 224.]

The Court rejected petitioners' attempt to distinguish the above-cited cases by virtue of the contingent nature of petitioners' right to reimbursement, asserting that:

This Court, however, has previously held that living expenses and medical expenses advanced to clients under contingent fee (and contingent reimbursement) contracts are in the nature of loans and thus not deductible under section 162(a). **Warren Burnett,** 42 T.C. 9 (1964), affirmed and remanded 356 F. 2d 755 (C.A. 5, 1966), certiorari denied 385 U.S. 832 (1966); **Reginald G. Hearn,** 36 T.C. 672 (1961), affd. 809 F. 2d 431 (C.A. 9, 1962), certiorari denied 373 U.S. 909 (1963). In our opinion those cases are not distinguishable, as petitioners suggest, as instances of mere money-lending, unrelated to the taxpayer's law practice. The plain holding of the **Burnett** case is that "petitioner's expenditures constituted advances to his clients which were virtually certain to be repaid and, consequently, were not deductible as business expenses." 356 F. 2d at 759. The Court of Appeals pointed out that the requirements of a loan for purposes of section 166 do not determine what constitutes an ordinary and necessary business expense under section 162(a). In view of petitioners' practice of screening clients and their "good hopes" of recovery, we think it is clear that the advances herein were intended to, and did, operate as loans rather than expenses under section 162(a). [53 T.C. at 224.]

Dismissing petitioners' further arguments, the Court went on to state that:

> Petitioners attempt to distinguish the **Burnett** case on the ground that it involved advances of significant amounts of money for living expenses. Certainly the amount of the expenditure does not determine whether the advances fall into the category of deductible business expenses. And, as we view it, the different **uses** of the advanced funds is a distinction without substance. What is important is the nature of the facts and circumstances under which the expenditures are made. If expenditures are made with the expectation of reimbursement, it follows that they are in the nature of loans, notwithstanding the absence of formal indebtedness. * * *
>
> Petitioners stress that their position is no different from the ordinary businessman who makes expenditures only on the likelihood that he will recover them in the course of business. We believe the situations are different. Here petitioners have made expenditures on behalf of a particular client, under a reimbursement agreement signed by the client, to pursue a claim held by the client — a claim of no use to any person other than the client.

In reality, they are the client's expenditures.

[53 T.C. at 225; cits. and fn. reference omitted.]

In **Herrick v. Commissioner, supra,** this Court found that the failure of the record therein to reveal the specific agreement between the petitioner and his clients provided " * * * no factual or legal distinction between this case and **Adolph B. Canelo III** * * *." 63 T.C. at 567; accordingly, we there held that the litigation costs advanced by petitioner on the understanding that petitioner would be repaid from the recovery of the client were in the nature of loans, not deductible business expenses.

Applying the **Canelo** and **Herrick** cases to the instant situation, we find no merit in petitioner's contention that the contingent character of the firm's right to reimbursement precludeds treatment of advanced costs as loans. See **Canelo v. Commissioner, supra,** at 224. Similarly, we can accord no significance to petitioner's assertion that the right to repayment is derived from the receipt of proceeds rather than the personal obligation of the client. See **Canelo v. Commissioner, supra** at 225.

Nor do we believe that petitioner's prospects of recovery were so uncertain as to distinguish the instant circumstances from those in **Canelo** and

Herrick cases. We recognize, as petitioner points out, that in both the **Canelo** and **Herrick** cases, some screening procedures were used to select the claims which would be prosecuted on a contingent fee basis, whereas petitioner's firm apparently handled all of its personal injury and workmen's compensation cases on a contingent fee, and that in both cases the Court expressly found that costs were advanced with "good hopes" and/or a "reasonable expectation" of recovery.

Such differences do not a distinction make. Petitioner testified that the firm pursued only those clients' claims which after initial consultation were considered meritorious. In essence, petitioner, too, engaged in a sort of screening process to select the

cases subject to a contingent fee arrangement, the net effect of which was to increase the likelihood of recovery. Any argument to the contrary is undermined by the fact that the bulk of petitioner's practice and major source of income was derived from personal injury and workmen's compensation cases.

Moreover, petitioner presented no evidence as to the number of cases prosecuted on a contingent-fee basis which resulted in no recovery or a recovery

insufficient to cover the costs incurred. Nor did petitioner offer evidence to show what amount and percentage of the total case preparation and litigation costs incurred in a particular year were not ultimately recovered. In the absence of any such proof by which we might more precisely assess the prospect of recovery, we find no basis upon which to distinguish the instant case from **Canelo v. Commissioner, supra,** and **Herrick v. Commissioner, supra.**

In addition to contesting respondent's theory of this issue, petitioner contends that the amounts disallowed by respondent are unreasonable and inaccurate by virture of respondent's failure to make a more extensive examination of petitioner's books and records. Suffice it to say that it is

petitioner who bears the burden of proof herein; if examining the firm's books and records would have revealed facts to disprove the correctness of respondent's determinations, it is petitioner's failure to do so which is of consequence herein.

Similarly, we find petitioner's resort to alleged record-keeping difficulties created in accounting for the advances as loans to be unavailing. Cf. sec. 6001. Indeed, as indicated in our findings, **supra**, as to the firm's bookkeeping practices, the firm did maintain sufficiently detailed records from which to ascertain the costs to be accounted for as loans, given time to do so.

On the basis of the foregoing, we hold that the case-preparation and litigation costs paid in each of the years 1968 through 1972, inclusive were in the nature of loans and as such, do not constitute business expenses deductible under section 162.

With regard to the "Extra-ordinary Employee Expenses" incurred incident to the firm's liaison activities and that were deducted by petitioner in each of the years 1968 through 1971, inclusive, the issue raised thereby is whether such . . .

APPENDIX "D"

INCOME TAXES
26 USCS §162(a)

§162. Trade or business expenses.

(a) In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceeding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congres-

sional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

APPENDIX "E"

RULES OF PROFESSIONAL CONDUCT OF THE CALIFORNIA STATE BAR

RULE 5-104. PAYMENT OF PERSONAL OR BUSINESS EXPENSES INCURRED BY OR FOR A CLIENT.

(A) A member of the State Bar shall not directly or indirectly pay or agree to pay, guarantee, or represent or sanction the representation that he will pay personal or business expenses incurred by or for a client, prospective or existing and shall not prior to his employment enter into any discussion or other communication with a prospective client regarding any such payments or agreements to pay; provided this rule shall not prohibit a member:

(1) with the consent of the client, from paying or agreeing to pay to third persons such expenses from funds collected or to be collected for the client; or

(2) after he has been employed, from lending money to his client upon the client's promise in writing to repay such loan; or

(3) from advancing the costs of prosecuting or defending a claim or action or otherwise protecting or promoting the client's interests. Such costs within the meaning of this subparagraph (3) shall be limited to all reasonable expenses of litigation or reasonable expenses in preparation for litigation or in proving any legal services to the client.

(B) Nothing in Rule 5-104 shall be deemed to abrogate any of the provisions set forth in Rules 5-101 through 5-103.[10/]

(C) Nothing in this Rule 5-104 shall prohibit a member of the State Bar from reading or showing this Rule to a prospective client and describing the nature and extent of the conduct prohibited by this rule.

10/ Rules 5-101 through 5-103 are not pertinent to the issues involved in the instant Petition.

Opposition

Office - Supreme Court, U.S.
FILED
OCT 15 1981
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CLERK

No. 81-544

In the Supreme Court of the United States

OCTOBER TERM, 1981

RONALD R. SILVERTON AND B. SILVERTON, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question presented in this federal income tax case is whether the decision below correctly held that the litigation costs advanced by petitioner's[1] law office on behalf of its clients were not deductible as ordinary and necessary business expenses.

The pertinent facts may be summarized as follows: During the tax years 1968 through 1972, petitioner operated a law office specializing in the prosecution of personal injury claims. Most of the office's cases were handled on a contingent fee arrangement. As part of this arrangement, the office would initially advance the case preparation and litigation costs incurred in prosecuting the client's case, and

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[1]References to "petitioner" are to Ronald R. Silverton. B. Silverton, his wife, is a party to this case only because she filed a joint return with him for one of the taxable years at issue.

would recover these costs only to the extent of any settlement or judgment award it later obtained. On his tax return, petitioner deducted these costs in the years they were paid, treating them as ordinary and necessary business expenses. In cases in which the office recovered some of these costs as the result of obtaining a favorable settlement or judgment in the client's case, petitioner took these amounts back into income in the year of recovery (Pet. App. 33-37).

On audit, the Commissioner of Internal Revenue determined that the advanced costs were in the nature of loans to petitioner's clients, and thus were not deductible as business expenses in the years the advances were made. The Commissioner, however, did allow petitioner to deduct these advances in any year in which a client's case was lost or otherwise "closed" (as no longer presenting a viable claim) by petitioner's office without its having recovered these advances (Pet. App. 37-38). The Tax Court, relying on its decisions in *Canelo* v. *Commissioner*, 53 T.C. 217 (1969), aff'd per curiam, 447 F. 2d 484 (9th Cir. 1971), and *Herrick* v. *Commissioner*, 63 T.C. 562 (1975), upheld the Commissioner's determination. The court of appeals affirmed on the authority of its *Canelo* decision (Pet. App. 21-24, 26-47).

The decision below correctly held that petitioner's advances to his clients were not deductible business expenses until the particular case was closed. It is well settled that where a taxpayer makes expenditures on behalf of another under an agreement that he will be reimbursed therefor, the expenditures are in the nature of loans or advancements and are not deductible as business expenses. *Flower* v. *Commissioner*, 61 T.C. 140, 152 (1973), aff'd in unpublished order, 505 F. 2d 1302 (5th Cir. 1974); *Canelo* v. *Commissioner, supra*, 53 T.C. at 224; *Patchen* v. *Commissioner*, 27 T.C. 592, 600 (1956); see *Glendinning, McLeish & Co.* v. *Commissioner*, 61 F. 2d 950, 952 (2d Cir. 1932);

Island Petroleum Co. v. *Commissioner*, 57 F. 2d 992, 994-995 (4th Cir. 1932). This is a case where the taxpayer's right to reimbursement is a contingent one. As the court stated in *Island Petroleum Co.* v. *Commissioner, supra*, 57 F. 2d at 994. "[A] loan is no less a loan because its repayment is made contingent; and a taxpayer has no right to treat it as a loss until the contingency has occurred or its worthlessness has been otherwise determined." Thus, where as here, the costs advanced by petitioner's office were those of his clients and were paid under agreements giving him a contingent right of reimbursement, the decision below correctly held that the costs were not deductible in the years they were paid.[2]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

OCTOBER 1981

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[2]Petitioner contends (Pet. 12, 17-18) that his situation is like that of a merchant or other businessman incurring costs to prepare his product for the marketplace. But his analogy is misplaced, for while the costs incurred by a merchant are clearly his own, the costs advanced by petitioner are those of his clients. See *Canelo* v. *Commissioner, supra*, 53 T.C. at 225.